

## INTEGRATING ACQUIRED RESOURCES AND CAPABILITIES

### HOW THE STRATEGIC EXPLORATION AND EXPLOITATION ORIENTATION OF TARGETS AFFECTS THE IMPACT OF HUMAN AND TASK INTEGRATION

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#### ABSTRACT

In this paper we investigate the effects of human and task integration with respect to the strategic orientation of target firms. This approach is necessary, as prior empirical research is not univocal about the integration performance relationship. We argue that there is no “one size fits it all” integration strategy, as detrimental or beneficial effects of integration depend rather on the target strategy, structure and culture than on strategic fit. We give empirical evidence from 101 transactions with acquirers from the German speaking part of Europe that if an integration strategy is beneficial or detrimental depends on the strategic exploration and exploitation strategy of targets. While human integration is most beneficial in cases of a solely high strategic exploration or exploitation orientation when the vice versa strategy is rather low, task integration is only beneficial in cases of a low and high combined exploration and exploitation orientations. We conclude that the creation of mutual trust and a shared identity is a precondition for resource sharing and capability transfer. Nonetheless, this transfer is not always necessary to create value.

*Keywords: Knowledge, management, organizational behavior, M&A, integration*

## 1. INTRODUCTION

Mergers and Acquisitions (M&A) are a highly complex phenomenon that has gained attention from several managerial research disciplines in the last three decades (Cartwright & Schoenberg, 2006). Next to the ascribed importance for management research the annual value of the market for corporate control exceeds the GDP of large sized countries like Brazil. Nevertheless M&A are highly risky and it is stated that 40-60% of acquisitions fail in creating value, some authors indicate an even higher number between 70-80% (Christensen, Alton, Rising, & Waldeck, 2011). Even though research on the M&A phenomenon has been undertaken for several decades – with early researchers like Kitching, 1967 – the success rates have not changed yet. By now numerous variables, from the fields of finance, strategy, organization, and process research have been used to explain M&A success (Haspeslagh & Jemison, 1991) (Birkinshaw, Bresman, & Håkanson, 2000). Nonetheless after conducting a meta-analysis on M&A success-factors, King and colleagues come to the conclusion that the impact of most commonly used research variables like relatedness, acquisition experience, or the mode of payment have no significant effect on the post-acquisition performance (King, Dalton, Daily, & Covin, 2004).

One major reason for these inconclusive results can be argued with the fact that value creation emerges in post-merger integration (Haspeslagh & Jemison, 1991). Nonetheless, post-merger integration is a multifaceted group of themes as it involves the cultural-, physical-, and procedural realignment of organizations (Shrivastava, 1986). Birkinshaw and colleagues separate integration into human and task integration while human integration on the one hand has the aim to create mutual trust and a shared identity and task integration on the other hand is responsible for resource sharing and capability transfer (Birkinshaw et al., 2000). Thus, the integration strategy as a combination of the desired level human- and task-integration is decisive for the M&A outcome. Nonetheless the chosen integration strategy is not free of restrictions as it depends on pre-merger characteristics of the involved firms.

For decades research has argued that a fit between acquirer and target is beneficial for the M&A outcome due to several reasons. A fit on industry level, assessed with branch codes, leads to greater success via economies of scale and the elimination of redundant resources than acquisitions in unrelated industries (Capasso, Dagnino, & Lanza, 2005). Another stream in the strategy literature proposes a resource fit or complementarity as a decisive success-factor and argues that fit is an indicator for potential synergies (Pehrsson, 2006; Tanriverdi & Venkatraman, 2005). Nonetheless it must be stated, that the empirical results of the strategic fit literature – even though the results provide us with more or less positive indications (Swaminathan, Murshed, & Hulland, 2008) – do not explain the value creating mechanisms in M&A, as it mainly analyzes direct effects on performance (Bauer & Matzler, 2013). Another argument, why the fit literature is too narrowly considered can be found in the acquisition motive. Christensen and colleagues state that firms are engaged in transactions due to two reasons, namely to improve the current performance of the acquirer or to reinvent the existing business model (Christensen et al., 2011). While a strategic fit is decisive for the first reason, it is insignificant for the latter one. Consequently it is hardly surprising that many empirical studies on strategic fit provide us with inconclusive results.

Based on this initial situation, our study makes two major contributions. First, we analyze the strategic exploration and exploitation orientation of targets instead of simply focusing on the fit between acquirer and target as the strategic orientation is decisive for the integration strategy and their potential to create value. Secondly, we investigate the role of human and task integration as value creating mechanisms in respect to the strategic orientation of targets. To analyze this dependency is necessary due to the fact that firms – acquirers and targets – differ in terms of strategy, structure and organizational culture. Consequently schemes and manuals fostering a “one size fits it all” integration strategy are not target-aimed as they disregard the uniqueness of organizations. In the following section we develop our research model and our hypotheses.

## 2. RESEARCH MODEL AND HYPOTHESES

Ambidexterity theory is a quite popular topic in organizational and strategic management research. Ambidexterity means, that individuals or organizations (in the latter we focus on organizational ambidexterity) have the capacity to be equally skillful with two different things (Birkinshaw & Gupta, 2013). The conceptual distinction in ambidexterity literature is exploration and exploitation. While exploration is characterized by risk, innovation, and discovery, exploitation is connected with efficiency, production, and selection (He & Wong, 2004). Both orientations require different organizational structures and cultures, consequently they have to be treated different (Ancona, Goodman, Lawrence, & Tushman, 2001; Lewin, Long, & Carroll, 1999). As firms, dependent on the specification of their exploration and/or exploitation orientation, are unique with regards to structure and culture, we argue that in the case of M&A according to the ambidexterity framework unique firms are acquired. These firms have to be treated individually, as the effects of integration differ according to the targets exploration and exploitation orientation.

M&A integration has received much attention in the last three decades and is cited to be the most important value creating mechanism in M&A (Haspeslagh & Jemison, 1991). Since Shrivastava's seminal work in 1986 on M&A integration, there is a growing recognition that integration itself is a multifaceted construct. By now, the separation of human and task integration – as both have different objectives – is widely accepted and used in empirical research (Birkinshaw et al., 2000). The main aim of human integration is the reduction of uncertainty that is created by M&A (Seo, 2005), consequently human integration is about the creation of a shared identity among employees (Birkinshaw et al., 2000). The socialization of humans in the target and the acquirer organization is beneficial for the working atmosphere and the collaboration among employees (Buono, Bowditch, & Lewis, 1985). Olie finds that human integration fosters a common purpose of the organization and is beneficial for the realignment of the organizational structure (Olie, 1994). Based on these arguments we hypothesize a positive effect of human integration on performance. Thus:

*H1: Human integration is in general beneficial for M&A performance*

Nonetheless, integration is not always necessary, as integration leads to disruption. In a recent study, Paruchuri and colleagues found empirical evidence that integration can lead to substantial performance drops due to the fact that technical personnel and inventors lose their social status in the new combined entity (Paruchuri, Nerkar, & Hambrick, 2006). Furthermore Puranam et al. found empirical evidence that integration is not always necessary. They argue that costs of disruption and integration in technology acquisitions can be avoided as a pre-existing common ground (an informal coordination mechanism) could be an alternative path for integration (Puranam, Singh, & Chaudhuri, 2009). Nonetheless, without any integration resource redeployment and exploitation are not possible (Cording, Christmann, & King, 2008; Homburg & Bucerius, 2006). In general, even though the empirical results on integration are not univocal, it seems that at least a certain degree of integration is beneficial (Chatterjee, Lubatkin, Schweiger, & Weber, 1992). Consequently we argue that the effects of human integration depend on the strategic orientation of target firms. While for firms with a strong exploration focus integration would be a disruption, in the case of targets with a strong exploitation focus integration would be necessary due to resource redeployment and the reduction of redundant resources (King et al., 2004). Thus we conclude the following hypothesis:

*H2: The effect of human integration depends on the joint influence of the level of the strategic exploration and exploitation orientation of targets in the following way:*

- a) *A high level of human integration is beneficial in the case of low exploration and exploitation orientation.*
- b) *A high level of human integration is beneficial in the case of low exploration and high exploitation orientation.*
- c) *A high level of human integration is detrimental in the case of high exploration and low exploitation orientation.*
- d) *A high level of human integration is beneficial in the case of high exploration and high exploitation orientation.*

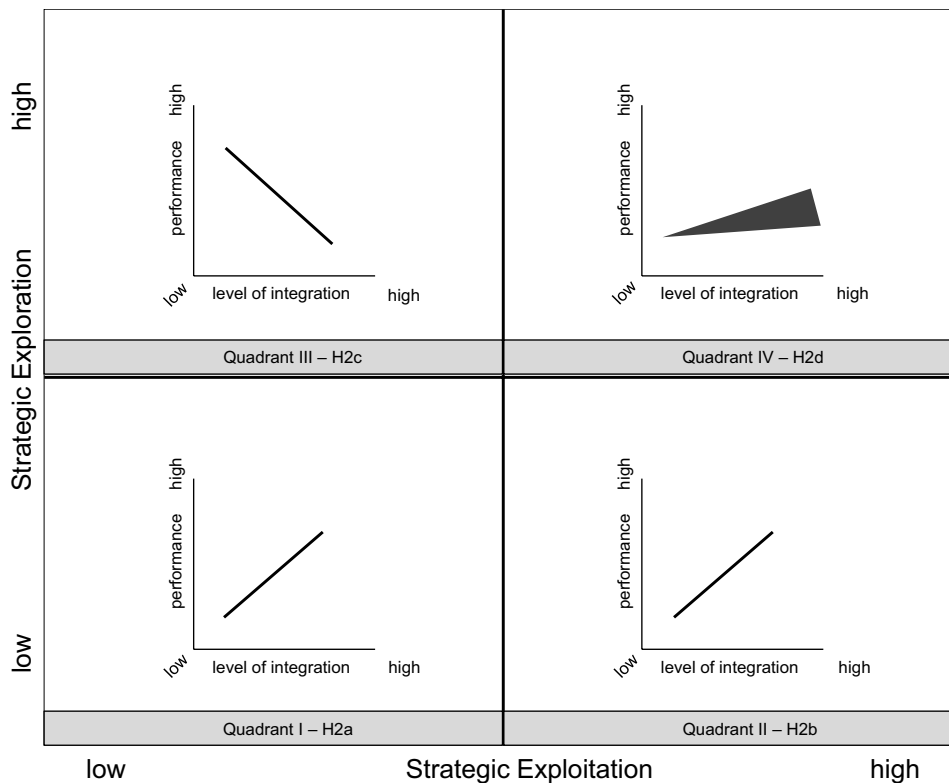


Figure 1: Assumed Effects of Human Integration on Performance within quadrants

Task integration is defined as the coordination for resource sharing and the transfer of capabilities (Birkinshaw et al., 2000). Consequently the achievement of operational synergies depends on the level of task integration (Andrade, Mitchell, & Stafford, 2001). As synergy is a major aim of M&A, we hypothesize in general a positive effect of task integration on performance. Thus:

*H3: Task integration is in general beneficial for M&A performance*

Nonetheless, operational efficiency is not always a major goal of acquisitions. In the case of targets with a strong exploration focus, quick and rapid changes causes stress in the organization and therefore create conflicts (Lukas, Menon, & Bell, 2002). Furthermore the innovative output of the target firm drops, as changes would lead to disruptions (Paruchuri et al., 2006). On the other hand, the integration of production, marketing, and systems could create the base for the transfer of capabilities and the sharing of resources (Birkinshaw et al., 2000). Furthermore, redundant resources could be eliminated (Cording et al., 2008). Consequently we propose different effects for task integration, depending on the strategic orientation of the target firm:

*H4: The effect of task integration depends on the joint influence of the level of the strategic exploration and exploitation orientation of targets in the following way:*

- A high level of task integration is beneficial in cases of low exploration and exploitation orientation.*
- A high level of task integration is beneficial in the case of low exploration and high exploitation orientation.*
- A high level of task integration is detrimental in the case of high exploration and low exploitation orientation.*
- A high level of task integration is beneficial in the case of high exploration and high exploitation orientation.*

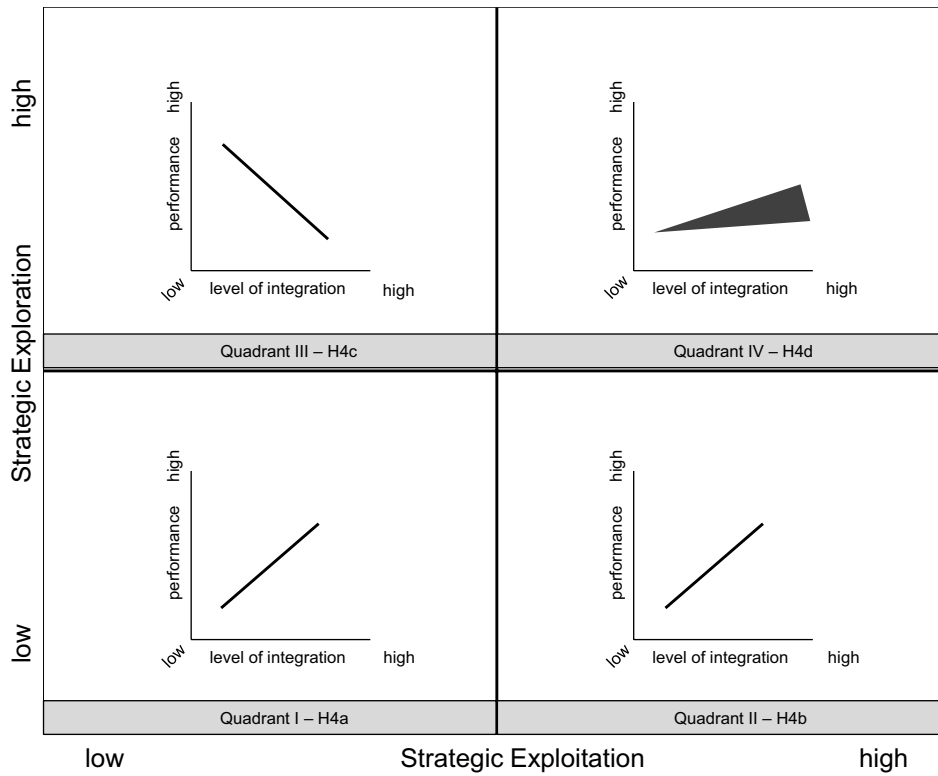


Figure 2: Assumed Effects of Task Integration on Performance within quadrants

In the next section we describe the methodology of our research. In detail we start with the sample and date, the measurement development, and switch to hypothesis testing.

### 3. METHODOLOGY

#### 3.1 Sample and data

For testing our research model and the corresponding hypotheses we applied mail and internet survey methodology in early 2013. As our sample consisted of targets with a seat in the German speaking part of Europe, we had to identify executives in charge who had been at the target at the point of time of the transactions and who were involved in the integration process. Furthermore we focused on transactions that took place between 2007 and late 2010 to guarantee that the integration process was either finished or at a final stage (Bauer & Matzler, 2013; Ellis, Reus, & Lamont, 2009; Homburg & Bucerius, 2006). To be able to compare the transactions in our sample we excluded all transactions with a value larger than 200 million Euros. Our basic population was extracted from the Zephyr database. In sum we were able to identify 712 transactions. The envelopes and the e-mails were addressed to managers in charge which were mainly CEO's, CFO's, and upper Managers. Even though key informant research design has some inherent problems, we decided to address key informants as they tend to be most knowledgeable about the intention and the integration of the requested transaction (Ellis et al., 2009). After conducting follow-up phone calls we were able to receive 101 completed questionnaires. The main reasons for not-participating our study was a lack of time and corporate restrictions.

#### 3.2 Measurement development

For the development of our measurement models we relied on already existing and tested ones. This is in line with previous research that argues for the reliability of scales as well as the replicability (King et al., 2004).

For assessing the strategic orientation of target firms we employed the items developed by He and Wong (2004). Exploration and exploitation were assessed each with four items, measured on a five-point Likert-scale (He & Wong, 2004). The reliability of the scales is given as the Cronbach's Alpha value exceeds the recommended threshold of 0.7 (for exploration  $\alpha = 0.924$ ; for exploitation  $\alpha = 0.846$ ).

Human integration was assessed with three items according to Cording and colleagues (2008). We measured the three items with a seven-point Likert scale, ranging from 1=no changes at all to 7=complete changes. Again the reliability of the scale is due to the Alpha value given ( $\alpha = 0.855$ ).

Task integration was assessed as a second order construct with the first order constructs production integration (2 items,  $\alpha = 0.852$ ), marketing integration (3 items,  $\alpha = 0.928$ ), and systems integration (3 items,  $\alpha = 0.894$ ). All items were rated with a seven-point Likert scale, ranging from 1=no changes at all to 7=complete changes. This is in line with the original scale (Cording et al., 2008).

M&A performance is a broadly discussed topic in academic literature. By now there is no consensus about the nature and the measurement of M&A performance (Cording, Christmann, & Weigelt, 2010). Most studies with a financial background apply stock market based measures like CAR or CAPM. Nonetheless it is questionable if M&A performance is a one-dimensional issue (King et al., 2004) and if stock markets are able to display the real situation of firms. Apart from stock market based measures, accounting based measures are quite often used. Again, these measurements have some inherent criticism. As accounting standards are not compare-able across borders, they seem not applicable for assessing M&A performance. Different studies on the comparability of accounting standards found differences in e.g. profits (Weetman & Gray, 1991), measurement rules that affect earnings (Basu, Hwang, & Jan, 1998), and earnings management (Leuz, Nanda, & Wysocki, 2003). Even though key informant bias could be a serious concern, managerial ratings of M&A success have proven to correlate highly with secondary data (Datta, 1991). For our purposes we applied the measurement model from Becker which assesses performance with an objective and subjective dimension, each assessed with four items (Becker, 2005). Again we used a seven-point Likert scale. The Alpha values indicate, that reliability is given (objective dimension, 4 items,  $\alpha = 0.933$ ; subjective dimension, 4 items,  $\alpha = 0.894$ ). For further validation of our performance measure we have analyzed the percentage of firms that do not create value with acquisitions and compared it with secondary data. The averagely reported failure rates range from 40% to 60%. In our data ~ 50% of all acquisitions do not create value (Christensen et al., 2011). Thus we think that key informant bias is not a serious concern for our data.

## 4. RESULTS

### 4.1 Descriptive data and research approach

In sum we were able to use 101 questionnaires. As we have not applied a specific industry focus, our sample reflects the industry structure of the German-speaking part of Europe. 14.6% of transactions were in the manufacturing and engineering industry, followed by 5.8% from the automotive and 3.9% from the electronics industry. The average growth rate of the industry varies between more than 30% and minus 15%. The average industry growth rate is between 5% and 10% which reflects the real economic situation of the requested industries. The type of transaction is an additional indicator for the reliability of our sample. First of all, more than 70% of all transactions were acquisitions, while only 23% were mergers and secondly, nearly 90% of all transactions were horizontal and vertical. The relative size of targets is rather small, about 38% below 25% and 30% between 25-49%. A last indicator for the reliability of our data is the acquisition experience. As our sample consists of medium sized firms, the acquisition experience, assessed in number of transactions in the last five years, is rather low. More than 50% had no, or one to two prior transactions.

Before starting to evaluate our hypothesis we assessed the external and internal validity of our data. First of all we assessed a potential non sampling bias. One approach to test is to examine several variables as well as their means and their distribution, and to compare them with data from the basic population (Klarmann, 2008). As shown in the previous section, the characteristics of our sample are equal to the real situation in the German speaking part of Europe. Secondly we assessed late- or non-response bias. Armstrong & Overton (1977) did empirical research on non-response bias in mail survey and found support for the assumption that there are similarities in answering behavior between late respondents and those who were not participating in a survey (Armstrong & Overton, 1977). Consequently, the approach to test for a late- or non-response bias is to analyze potential differences between early- and late-respondents (Van der Stede, Wim A., Mark Young, & Xiaoling Chen, 2006). The results of our Wilcoxon-Mann-Whitney Test do not indicate any differences. A third source for external validity problems is the different strokes bias. We have compared mail and online respondents and again, we found no significant differences. A major source for internal validity complications is common method bias, as we have collected dependent and independent variable in one survey (Podsakoff, MacKenzie, Lee, & Podsakoff, 2003). According to Podsakoff & Organ (1986), the data is likely to be distorted by a common method bias when only one single factor is extracted or when one factor explains the majority of the variance. Consequently, the Harman's one factor test was conducted (Podsakoff & Organ, 1986). The analysis resulted in 14 different factors which indicate that common method bias is not a serious concern for our data.

### 4.2 Hypotheses testing

For assessing our hypothesis we applied OLS regressions as we have used interval scales in our questionnaire. The regression outcomes support several of our Hypotheses stated in section two. Over all observations, the proposed positive effects of human integration (as stated in H1) and task integration (as stated in H3) on M&A performance could be confirmed with a beta values of 0.173+ and 0.276\* showing significance on a 10 and 5 percent level. However, in case of low levels of exploration and exploitation, anticipated positive effects of human integration on acquisition performance (H2a) found no support whereas task integration shows a highly significant positive effect (+0,665\*\*\*) on performance (H4a) in quadrant I.

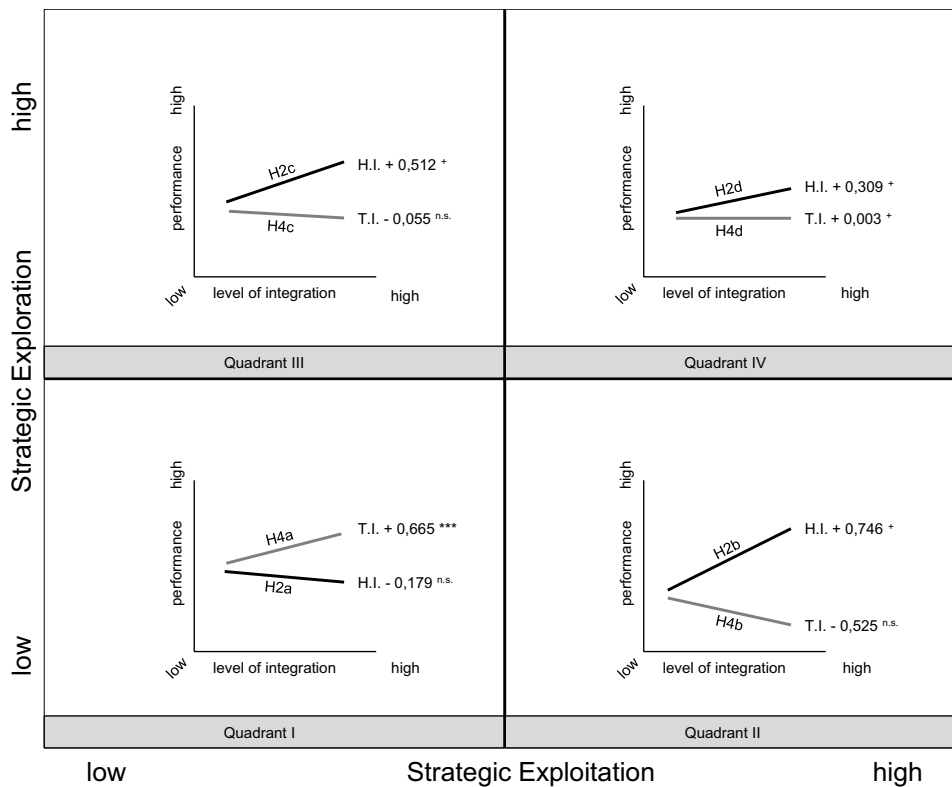


Figure 3: OLS Regression Results

Conversely, our results suggest a beneficial impact of human integration ( $\beta$ -value of 0,746+) on a 10% level in quadrant II which supports Hypothesis 2b while H4b – a positive relationship of task integration on M&A outcome – could not be confirmed. Despite our principal negative assumptions in H2c, our results imply a positive effect of human integration obviously boosting performance with a  $\beta$  of 0,512 on a 10% level in quadrant III. Thus we argue that with a greater sample, the effect would flip to support the Hypothesis we originally stated. H4c found no support while both, H2d and H4d presuming moderate positive impact on M&A performance show got supported on a 10% level in quadrant IV. The coefficients of determination ( $R^2$ ) vary from 0,110 to 0,296 in all quadrants displaying a rather high explanatory power of the OLS regressions. Also, possible doubts with underlying multicollinearity in our model could be eliminated by testing variables individually.

## 5. DISCUSSION

Our research is to some extent in line with prior empirical studies which state that integration after acquisitions is important (Birkinshaw et al., 2000; Larsson & Finkelstein, 1999). Nonetheless our research contributes to existing knowledge as we analyze the effects of integration in dependency of the targets strategic orientation. Thus, ambidexterity is helpful in explaining the different effects of integration. Our research sheds light on the by now unequivocal research results as we found different positive and negative effects of both – human and task – integration. Even though both are interrelated constructs, they show no uniformity in the nature of their effects. This is in line with Birkinshaw et al. who state that human and task integration are conceptually distinct (Birkinshaw et al., 2000). Our research goes one step further as we found empirical evidence for Christensen et al. (2011) theory on the dependency of motives and integration. However we were able to extend their basic assumption that in case of exploration business models integration is detrimental as our results prove that at least a minimum of mutual trust and shared identity (the outcome of HI) is beneficial for post-merger performance. Though, sharing of resources and transferring capabilities is not generally essential when acquiring innovative business models. In non-knowledge intensive acquisitions mutual thrust and a shared identity are not explicit success factors. Furthermore firms should strive for quick realignment. Nonetheless if the target firm has a strong focus on exploitation, human integration is a precondition for closer task integration. This is in line with the findings



of Birkinshaw et al. (2000). If the target firm has a balanced business model with a strong focus on both ambidextrous dimensions, integration is a sensible success factor and firms should seek for structurally differentiated integration.

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